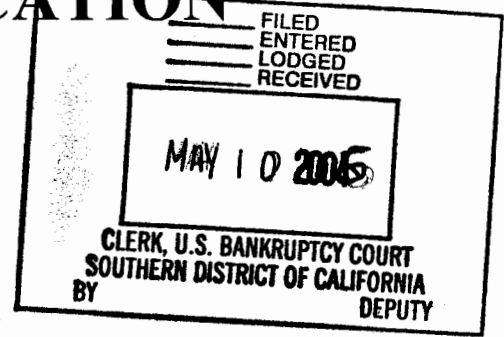
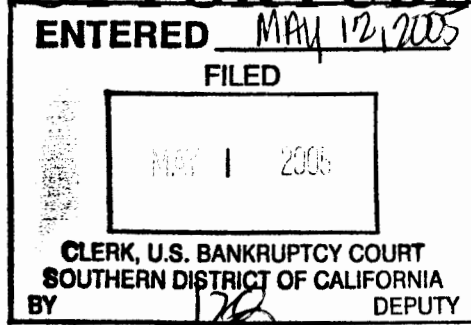


NOT FOR PUBLICATION



UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re
SAMUEL KELSALL,
Debtor.

MACK BARCLAY, INC.
Plaintiff,
v.
SAMUEL KELSALL,
Defendant.

Bankruptcy No. 04-10374
Adversary No. 05-90072

MEMORANDUM DECISION

The plaintiff, Mack Barclay, Inc. ("Plaintiff"), filed a nondischargeability complaint against the debtor and defendant, Samuel Kelsall ("Defendant"), on March 4, 2005. The Defendant filed a motion to dismiss the complaint, which the Court heard on May 5, 2005. The Court ordered the Plaintiff to file an amended complaint setting forth the Plaintiff's allegations of fraud with greater particularity. It also took under submission the issue of whether the Plaintiff could state a claim for relief under Section 523(a)(7), which is designated in the Plaintiff's complaint as the Fifth Claim for Relief.

1 The debt underlying the Fifth Claim for Relief concerns sanctions
2 awarded by a state court against the Defendant, payable to the
3 Plaintiff. The Defendant argues that since the sanctions are payable
4 to the Plaintiff they do not satisfy the requirements of Section
5 523(a)(7), which excepts from discharge debts "to the extent such debt
6 is for a fine, penalty, or forfeiture payable to or *for the benefit*
7 of a governmental unit, and is not compensation for actual pecuniary
8 loss."

9 The Plaintiff counters that an award of sanctions can be for the
10 benefit of a governmental unit, even if made payable to a party. It
11 cites to In re Allison, 176 B.R. 60 (S.Fla. 1994). In that case, the
12 court stated that "in the case of contempt judgments, it is enough
13 that the fine or penalty, although made payable to a party, be awarded
14 to vindicate the dignity and authority of the court." Id. at 64.

15 The Ninth Circuit Court of Appeals has cited to Allison with
16 approval in dicta. In re Hercules Enterprises, Inc., 387 F.3d 1024
17 (9th Cir. 2004). In Hercules Enterprises, the bankruptcy court found
18 an insider of the corporate debtor in contempt of court and awarded
19 sanctions roughly equal to the fees and costs incurred by the trustee
20 in pursuing the matter. The bankruptcy court also ruled that the
21 sanctions would be nondischargeable in any subsequent personal
22 bankruptcy case, if the insider were to file such a case.

23 The Ninth Circuit upheld the sanction, but reversed the
24 bankruptcy court's ruling that the debt would necessarily be
25 nondischargeable in a subsequent proceeding. The Ninth Circuit held
26 that it was not within the bankruptcy court's jurisdiction to
27 essentially pre-determine the issue of nondischargeability.

28 In the course of that discussion, however, the Ninth Circuit

1 stated that the general principle of law was that sanctions awarded
2 to uphold the dignity and authority of the court are nondischargeable
3 under Section 523(a)(7). The Ninth Circuit then stated that the
4 contempt sanction involved in the case before it did appear to be the
5 type of debt that generally would be nondischargeable pursuant to
6 Section 523(a)(7).

7 The Hercules Enterprises court also cited to In re Buscher,
8 89 B.R. 154 (D. Kan. 1988). In reviewing how courts applied Section
9 523(a)(7) to sanction awards, the Buscher court noted that the
10 determining factor was whether the fine was compensatory and primarily
11 for the benefit of the creditor, or whether it was intended primarily
12 to be for the benefit of the government. Section 523(a)(7) only
13 applied in the latter situation. This is consistent with the
14 provision of Section 523(a)(7) that states the debt in question must
15 not be compensation for actual pecuniary losses. The implication of
16 the Ninth Circuit's opinion in Hercules Enterprises is that as long
17 as a sanction award is intended by a court to act as a fine or
18 penalty, such as a coercive sanction, then it can be nondischargeable
19 under Section 523(a)(7), even if the court set the amount of the award
20 based on the fees and costs incurred by the party to whom the
21 sanctions were to be paid.

22 The Ninth Circuit in Hercules Enterprises did not discuss its
23 prior opinion in In re Taggart, 249 F.3d 987 (9th Cir. 2000), likely
24 because the actual issue of nondischargeability was not before it at
25 that time. In Taggart, the Ninth Circuit drew a distinction between
26 sanctions awarded as punishment pursuant to a state statute and a
27 monetary award imposed to compensate the creditor for costs incurred.
28 The debtor, an attorney, was disciplined by the State Bar and, as part

1 of that proceeding, was ordered to pay the costs incurred by the State
2 Bar in bringing the proceeding against the debtor. In a subsequent
3 bankruptcy case, the State Bar argued that the award of costs was a
4 sanction that was nondischargeable pursuant to Section 523(a)(7). The
5 Ninth Circuit disagreed.

6 It pointed out that under the applicable statute the debtor was
7 ordered to pay costs to the State Bar for its "actual expense
8 incurred" by the State Bar. 249 B.R. at 992; Cal. Bus. And Prof. Code
9 § 6086.10. The Panel stated that, in contrast, under Cal Bus. and
10 Prof. Code § 6086.13, a monetary sanction in a fixed amount could be
11 imposed as a penalty in conjunction with disciplinary matters against
12 an attorney. It then explained the meaning of the distinction as
13 follows:

14 First, the fees levied under § 6086.10 are denominated
15 "costs" and are imposed to reimburse the State Bar for
16 "actual expenses" and "reasonable costs" associated with
17 disciplinary hearings. Id. §§ 6086.10(a), (b). By
18 contrast, fees authorized by § 6086.13 are described as
19 "monetary sanctions" and are not dependent on any
20 expenditure by the State Bar for their imposition. All
21 that is required is that the attorney suffer the sanction
22 of suspension or disbarment. Id. § 6086.13(a). It is also
23 noteworthy that a disciplined attorney may be excused from
24 paying costs under § 6086.10 on the grounds of "hardship,
25 special circumstances, or other good cause." Id. §
26 6086.10(c). No such exception exists for an attorney
27 ordered to pay monetary sanctions under § 6086.13. See id.
28 § 6086.13(e) (limiting collection of monetary sanctions to
circumstances in which collection would "impair the
collection of criminal penalties or civil judgments arising
out of transactions connected with the discipline of the
attorney"). This supports the impression that the
California legislature intended monetary sanctions under §
6086.13, but not costs awards under § 6086.10, as
punishment.

249 B.R. at 992.

In In re Warfel, 268 B.R. 205 (9th Cir. BAP 2001), the Panel
noted that the penal nature of criminal restitution is not altered by

1 the fact that the amount of the restitution award is based on the harm
2 caused by the defendant, relying on the Supreme Court's decision in
3 Kelly v. Robinson, 479 U.S. 46 (1986). The determining factor is
4 whether the award was intended as a penalty or fine, irrespective of
5 whether the restitution imposed was then equivalent to the damages
6 suffered by the creditor. 268 B.R. at 210. "Only monetary sanctions
7 that are intended as punishment are 'fines or penalties,' as that term
8 is used in § 523(a)(7)." Id.

9 The Plaintiff has alleged that the "primary purpose of the
10 sanctions orders [was] to the punish Kelsall and deter further conduct
11 contrary to statute." The facts, as they develop further, may
12 eventually indicate otherwise, and may show that the sanctions awarded
13 were purely to compensate the Plaintiff, and not imposed as a
14 punishment. But at this stage of the proceedings, based on a review
15 of the complaint and the applicable case law, the Court is satisfied
16 that the Plaintiff has stated a claim for relief under Section
17 523(a)(7), and therefore, the Court denies the Defendant's motion to
18 dismiss the Plaintiff's Fifth Claim for Relief.

19 Counsel for the Plaintiff shall file an order consistent with
20 this Memorandum Decision within 14 days of the entry of this
21 Memorandum.

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MAY 10 2005

Date: _____



Hon. James W. Meyers
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA
325 West F Street, San Diego, California 92101-6991

In re Bankruptcy Case No(s). 04-10374
Adversary No(s). 05-90072

CERTIFICATE OF MAILING

The undersigned, a regularly appointed and qualified clerk in the office of the United States Bankruptcy Court for the Southern District of California, at San Diego, hereby certifies that a true copy of the attached document, to wit:

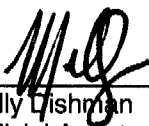
Memorandum Decision

was enclosed in a sealed envelope bearing the lawful frank of the bankruptcy judges and mailed to each of the parties at their respective addresses listed below:

Donald English
English & Gloven
550 West "C" Street, Suite 1800
San Diego, CA 92101

Samuel Kelsall
2921 Roosevelt Street
Carlsbad, CA 92008

Said envelope(s) containing such document was deposited by me in a regular United States Mail Box in the City of San Diego, in said District on May 11, 2005.



Molly Lishman
Judicial Assistant to the Honorable James W. Meyers